No. 16039

In the United States Court of Appeals for the Ninth Circuit

HERALD A. O'NEILL and G. EVELYN O'NEILL, his wife, PETITIONERS,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 106-130)[1] are not officially reported.

JURISDICTION

This petition for review (R. 131-135) involves deficiencies in federal income taxes for the calendar years 1951 and 1952 in the respective amounts of

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[1] Record references are to the pages of the typewritten transcript of record filed by the taxpayer.

$1,154.78 and $10,635.90, and an addition to tax under Section 294(d)(1)(A) of the 1939 Code for the year 1952 in the amount of $903.60 (R. 131-132). A notice of deficiency was mailed to the taxpayers on February 25, 1955. (R. 8-12, 14.) On May 23, 1955, the taxpayers filed a petition for redetermination of those deficiencies (R. 1, 3-7) under the provisions of Section 272(a) of the 1939 Code. On February 20, 1957, an amended petition was filed. (R. 2, 14-21.) The decision of the Tax Court was entered on January 13, 1958. (R. 2, 130-131.) The case is brought to this Court by a petition for review filed by the taxpayer [2] on March 21, 1958. (R. 2, 131-135.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court's finding, that the taxpayer is not entitled to a loss deduction for the year 1952 under Section 23(e) of the 1939 Code because he failed to carry his burden of proving that a loss was realized in that year as a result of transactions in connection with the Eagle Timber and Mill Company, is clearly erroneous.

2. Whether the Tax Court's finding, that the taxpayer's loss resulting from a transaction in which he was an escrow agent was not incurred in his trade or business, is clearly erroneous.

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[2] Since G. Evelyn O'Neill is involved solely because of the filing of joint tax returns for the taxable years (R. 107-108), her husband hereinafter will be referred to, individually, as the taxpayer.

3. Whether the Tax Court's finding, that the taxpayer failed to prove reasonable cause for his failure to file a declaration of estimated tax in the year 1952, is not clearly erroneous with the result that the taxpayer is liable for the addition to tax imposed by Section 294(d)(1)(A) of the 1939 Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations involved are printed in the Appendix, *infra.*

STATEMENT

The facts as found by the Tax Court (R. 107-119) may be summarized as follows:

The taxpayer married Evelyn, his second wife, on August 23, 1951, and they reside in Seattle, Washington. They filed joint income tax returns for the years 1951 and 1952 with the District Director of Internal Revenue at Tacoma, Washington. (R. 107-108.)

The taxpayer married his first wife, Phoebe T. O'Neill, on July 6, 1927, and was divorced from her on August 20, 1951. (R. 108.)

The taxpayer's trade or business during the taxable years and all related periods was that of an attorney. (R. 108.)

On September 4, 1946, the taxpayer purchased certain timber property, hereinafter referred to as the Timber Property, from H. H. and Mildred Longenecker. The latter parties executed on October 24, 1946, a statutory warranty deed and bill of sale which named the Eagle Timber and Mill Company

(hereinafter referred to as Eagle Timber) as grantee. The statutory warranty deed and bill of sale was filed with the Auditor of Kings County, Washington, on January 6, 1947. The stated consideration for the conveyance was $10. (R. 108.)

On September 9, 1946, the taxpayer executed an option to purchase certain portable sawmill machinery, hereinafter referred to as the Sawmill, from the Webster-Brinkley Company for $18,500. The Sawmill was at that time located on the Timber Property. The taxpayer extended the option eight times, and finally, on October 18, 1948, completed the purchase. He transferred the Sawmill to Eagle Timber prior to February 3, 1947. (R. 109.)

Eagle Timber was incorporated as a Washington corporation on October 22, 1946. Its articles of incorporation were filed with the Secretary of the State of Washington at Olympia, Washington. The incorporators were the taxpayer, his former wife Phoebe, and Tim Healy. The purpose of the corporation was to engage in a general logging, milling, plywood, timber, and lumber business. On February 18, 1947, articles of incorporation also were filed with the Auditor of King County. Filing fees were paid to the State of Washington and King County. (R. 109.)

On December 27, 1946, Eagle Timber executed a promissory note secured by a mortgage on the Timber Property in favor of C. F. Dally, in the amount of $24,908.49, which amount included a note given to Dally by H. H. Longenecker for $12,500, which note was secured by mortgages upon the Timber Property.

The taxpayer also executed a written guarantee at that time in which he agreed to protect personally and keep unencumbered the timber, and agreed that the corporation would properly account for the stumpage due the mortgagee. On May 4, 1948, Dally assigned the mortgage to the Seattle-First National Bank. (R. 109-110.)

On February 3, 1947, Eagle Timber executed a real estate and chattel mortgage in favor of Herbert D. Norris as security for a promissory note in the amount of $25,000. The mortgage security was the Timber Property and the Sawmill. (R. 110.) The mortgage provided that (R. 110)—

> [the] Mortgagor is the owner of said property, has good right and authority to mortgage the same, will defend the title to said property unto Mortgagee, except as stated herein, successors and assigns, against all claims whatsoever, and will provide Mortgagee promptly, and in no event later than ten (10) days after date hereof, or upon Mortgagee's demand, with all the documents, proofs and instruments governing title to said property, which any public authority or Mortgagee may request.

Norris came into the Eagle Timber venture at the same time, paying the taxpayer $10,000. On May 12, 1950, the taxpayer agreed to purchase all the right, title, and interest of every kind and character, of Norris, relating to the business of Eagle Timber, for $16,000, and on or before December 31, 1952, paid $2,000 on account of the purchase price thereof. (R. 110-111.)

On July 24, 1948, Eagle Timber, as vendor, agreed to sell the Timber Property and the Sawmill to Sterling Timber and Lumber Company for $90,000, payable in installments. This transaction was never completed but was abandoned by the purchaser. (R. 111.)

In 1948 Eagle Timber was a defendant in an action commenced by the Buda Engine & Equnipment Company, Inc., in the Superior Court of the State of Washington for King County. (R. 111.)

During the years 1946 through 1949, $20,556.60 was paid from community funds of the taxpayer and his then wife, Phoebe, in connection with the business of Eagle Timber. This amount included $18,500 paid to acquire the Sawmill from the Webster-Brinkley Company. (R. 111.)

On June 12, 1950, the taxpayer executed an assignment of interest in a fund on deposit with the Circuit Court of the State of Oregon for Douglas County to Seattle-First National Bank in the amount of $12,500, in consideration of the assignment and transfer by such bank of its interest as mortgagee in the timber standing and being on the Timber Property. By stipulation of the parties under date of November 14, 1951, there was distributed and paid the sum of $11,083.34 to the bank in full payment of the assignment. (R. 111-112.)

On July 1, 1950, Eagle Timber was dissolved by operation of law for failure to pay its annual corporate license fees for a period of three years. Eagle Timber has had no legal corporate existence in the State of Washington since that date. (R. 112.)

On September 26, 1951, the taxpayer delivered in escrow a deed executed by Eagle Timber to the Timber Property. This transaction was an attempt to sell the timber for $15,000 net. A title report by the Washington Title Insurance Company, which accompanied the deed, recited that title to the Timber Property was vested in the dissolved corporation. The broker who attempted to sell the Timber Property understood that he was dealing with a representative of the corporation. (R. 112.)

The taxpayer entered into negotiations with the H & L Timber Company with reference to sale of the timber on the Timber Property. On May 28, 1952, H & L Timber Company offered the taxpayer $11,500 for the timber, but the sale was never closed. (R. 112.)

On August 12, 1952, the taxpayer executed a bill of sale for the Sawmill located on the Timber Property in favor of J. A. Stafne for $12,500. Stafne paid the taxpayer with a note, secured by a mortgage on the Sawmill. Stafne intended to ship the Sawmill to the Philippine Islands in connection with a transaction with the Amer-Phil Lumber & Veneer Company, but it was agreed that it would not be shipped until the $12,500 purchase price had been paid. Stafne dismantled the Sawmill and shipped it to Seattle where it was stored awaiting shipment to the Philippines. Stafne never shipped the Sawmill to the Philippines, but subsequently went into business in Canada, and desired to use it in a corporation there. The security laws of British Columbia, however, required that the Sawmill be free and

clear of all encumbrances when transferred to the Canadian corporation. The taxpayer, therefore, released his mortgage on the Sawmill and took in lieu thereof as security Stafne's stock in the Portland Canal Development Company, Ltd., the company to which Stafne was going to transfer the Sawmill. The value of such stock was in excess of $12,500 at the time of the exchange. At the time of the hearing of this case Stafne still owed the taxpayer the full $12,500 sale price of the Sawmill. (R. 113.)

In November and December of 1952 the taxpayer negotiated with one Ward for the sale of the timber on the Timber Property. Ward offered the taxpayer $2,000 for the timber, which offer the taxpayer tentatively accepted. Ward gave the taxpayer a check for $500 on December 4, 1952, as earnest money, which check the taxpayer promised to hold until the spring. At that time Ward looked at the timber again and decided not to go forward with the purchase. The taxpayer never cashed the $500 check. (R. 113-114.)

On his income tax return for 1952 the taxpayer claimed a business bad debt loss of $33,639.84, as a result of his alleged sale to Ward of the timber on the Timber Property for $2,000 and his alleged sale to Stafne of the Sawmill for $12,500. (R. 114.) The computation was shown as follows (R. 114):

Bad debt loss—

Total loans to Eagle Timber and Mill Company	$58,139.84
Less: Amount reimbursed	10,000.00
Balance due	$48,139.84
Less: Amount recovered through foreclosure sale in 1952	14,500.00
Bad debt loss	$33,639.84

During the years from 1946 to 1951 taxpayer advanced money to Eagle Timber and Mill Company. The Company went broke and during 1952 taxpayer recovered $14,500.00 through sale of the company's assets.

In 1953 the taxpayer wrote off the $2,000 that he had failed to collect from Ward as a result of the alleged sale in 1952 of the timber on the Timber Property. The taxpayer stopped paying taxes on the Timber Property in 1953. (R. 115.)

There was never filed in the office of the auditor of the county in which Eagle Timber had its registered office an affidavit signed by a majority of the board of directors stating that the amount of paid-in capital with which it would commence business, as stated in the articles of incorporation, had been fully paid. (R. 115.)

Eagle Timber never filed any reports with the office of the auditor of the county in which it had its registered office or in the office of the Secretary of State, stating the total number of shares allotted and whether they had a par value or no par value, stating the consideration received for the shares allotted, or stating the valuation put upon the consid-

eration other than cash received in payment of the shares allotted. (R. 115.)

There were never any meetings of the shareholders of Eagle Timber held, as there were never any formal stockholders. No stock certificates were ever issued by Eagle Timber. (R. 115-116.)

Eagle Timber never filed with the auditor of the county in which it had its registered office any statement containing a list of all its directors and officers and their respective titles of office, names and addresses, and the term of office for which they had been chosen, as there were never any officers or directors formally elected. (R. 116.)

Eagle Timber never maintained any minute books or other books of records. (R. 116.)

The agreement of settlement between the taxpayer and his former wife, Phoebe, executed at the time of their divorce in 1951, did not make any specific reference to the interest of the marital community in Eagle Timber or its assets. (R. 116.) However, the agreement provided, in paragraphs 11 and 12, as follows (R. 116):

> 11. The wife does hereby assign, convey and transfer to the husband, all of her right, title and interest in and to all other life insurance policies heretofore issued upon the life of the husband, and his personal effects and office furniture and equipment and business accounts receivable.
>
> 12. The husband does hereby transfer, assign, convey, deed and release to the wife, all of his right, title and interest in and to all other property and assets of every kind and character,

real, personal or mixed and wheresoever situated.

The taxpayer was the attorney for the Lucky Music Company of America, a Nevada corporation (hereinafter referred to as Lucky Music). Lucky Music was engaged in the manufacture of machines which were combination slot machines and phonographs. The machines were designed in that manner so that they might be used in states where slot machines were illegal. During 1949 Ray Fezzler, Frank Magrini, and Leo Lamb entered into an agreement to purchase 25 of the above-mentioned machines for \$12,500. Under the terms of the agreement the purchase price of \$12,500 was to be paid to the taxpayer as an escrow agent, and he in turn was to pay it over to Lucky Music as the machines were constructed. The machines were completed and the taxpayer paid the escrow funds to Lucky Music. Fezzler, Magrini and Lamb, however, did not want the machines delivered until after an election in Tacoma. Delivery was therefore delayed, and meantime Lucky Music's officers took the machines out of the area in an attempt to promote them elsewhere. The officers never returned with the machines. (R. 116-117.)

Fezzler, Magrini, and Lamb then demanded that the taxpayer refund the \$12,500. On April 19, 1950, the taxpayer executed an assignment of interest in a fund on deposit with the Circuit Court of the State of Oregon for Douglas County to a trustee of the above-mentioned individuals in the amount of \$12,500. The sum of money found to be distributa-

ble and payable to the taxpayer was determined in the court proceeding on December 30, 1950; however, it was retained by the clerk of the court pending the determination, settlement, and adjudication of the rights of any assignees of such funds pursuant to assignments thereof by the taxpayer. On November 21, 1951, pursuant to a stipulation of the parties, there was distributed and paid by order of the court, the sum of $11,083.34 in full payment and settlement of the assignment and the demands and claims against the taxpayer, as escrow agent, of the $12,500. (R. 117-118.)

The taxpayer never recovered any amount of the $12,500 from Lucky Music, either prior to November 21, 1951, or subsequent thereto. (R. 118.)

The Tax Court found that Eagle Timber was a separate taxable entity during the period October 22, 1946, through July 1, 1950; that the transfers of the Timber Property and the Sawmill by the taxpayer to Eagle Timber constituted contributions to capital in that corporation (R. 118); that the taxpayer failed to prove that he realized a loss in 1952 as a result of the transactions concerning Eagle Timber (R. 125); and that the loss sustained by the taxpayer as a result of the transaction in which he acted as an escrow agent was personal in nature and was not incurred in his trade or business (R. 118-119). Accordingly, that court denied the taxpayer any loss deductions as a result of the transactions in issue. (R. 119-128.)

The Tax Court also found that the taxpayer's fail-

ure to file a declaration of estimated tax for 1952 [3] was not due to reasonable cause (R. 119), and hence affirmed the Commissioner's assertion of an addition to tax for that year (R. 128-129).

SUMMARY OF ARGUMENT

1. The taxpayer was the alleged owner of a corporation known as Eagle Timber and Mill Company. In 1950 Eagle Timber was dissolved and the taxpayer as alleged sole owner of the corporation received in liquidation all of its properties, which consisted of timber and a saw mill. The taxpayer alleges that in 1952 he sold the property so received and erroneously concludes that, since he received as a result of the alleged sales less than the amount of money he invested in the corporation, he sustained a loss in that year. He further mistakenly contends that his loss was deductible in full under Section 23(e)(1) or (2) of the 1939 Code as a business loss or as a loss sustained in a transaction entered into for profit, respectively.

Although, as the Tax Court found, the taxpayer did not prove that he realized a loss in 1952, it is necessary to first consider the nature of the loss if one were realized in that year—that is, would it be a capital loss subject to the limitations contained in the capital loss provisions of the Revenue Code, or would it be an ordinary loss deductible in full? The resolution of those questions will fix the relationship for tax purposes between the taxpayer and Eagle

[3] The year in question is misstated in the finding of the court as 1950. (R. 119.)

Timber and is essential to the determination of the basic question, which is whether the taxpayer proved by a preponderance of the evidence that he realized a loss in the taxable year 1952. It is, of course, well settled that an investment in a corporation constitutes a capital asset in the hands of a taxpayer who is not in the business of dealing in corporate shares of enterprises, and that any loss as a result thereof is deductible *only* as a capital loss. The taxpayer was not in business as a dealer in corporate shares or enterprises and was not otherwise in a business to which the alleged loss could be related; hence, he argues that the corporate entity should be ignored and that its business or venture should be considered his personal business or venture in which it is contended the loss was incurred. This argument has no merit.

It is well settled that a corporation tax-wise is a separate and distinct entity from the individual or individuals who own it and that the individual owner cannot appropriate the corporate business or activities unto himself merely to realize tax benefits. There is one exception to this rule which is that a corporation may be disregarded *only* where (1) the purpose for its creation was not a business purpose, *and* (2) its creation was not followed by any business activity. Eagle Timber was incorporated in the State of Washington on October 16, 1946, and existed as a corporate entity under local law until July 1, 1950, when it was dissolved. The purpose for its creation as stated in its articles was to engage in the general logging, milling, and timber bus-

iness. Subsequent to incorporation Eagle Timber, in its corporate name, entered into a logging contract, and executed deeds, mortgages and notes. Since, therefore, there was a legitimate business purpose for the creation of the corporation it may not be disregarded. Further, the record, as outlined, shows that there were business transactions executed in the corporate name, and for this additional reason the entity cannot be disregarded. Accordingly, the Tax Court's finding that Eagle Timber must be recognized for tax purposes is clearly correct.

Since Eagle Timber was a corporate entity separate, for tax purposes, from the taxpayer, the taxpayer's investment therein constituted a capital asset and any loss as a result of that investment is not deductible in full but is subject to the limitations contained in the capital loss provision of the Code. Moreover, when that corporation was dissolved in 1950 the taxpayer, for tax purposes, is considered as having received its properties in *exchange* for his investment and as realizing a gain or loss *at that time* measured by the difference between the basis of his investment and the fair market value of the property distributed to him. Hence, the taxpayer's basis for the purpose of determining gain or loss on a subsequent disposition of the properties is their fair market value at the time they were acquired by him, which was in 1950. This brings us to the basic question under this point, which is, whether the taxpayer carried his burden of proving that he realized a loss in 1952 when he allegedly sold the properties

he had received in liquidation and which were capital assets in his hands.

The question whether a taxpayer realized a loss in a particular year is one of pure fact upon which the taxpayer has the burden of proof. And, it is well settled that without proof of the tax basis of property it cannot be determined, upon a sale of the property, whether or not gain or loss has been realized. The trial court found as a fact that the taxpayer did not carry his burden of showing that he realized a loss since he did not prove his basis in the properties that he had received in 1950 as a result of the liquidation of Eagle Timber and which he allegedly sold in 1952. The taxpayer introduced no evidence with respect to the fair market value of the properties in 1950, and, therefore, the Tax Court's finding is fully supported by the record and is not clearly erroneous.

For the foregoing reasons, and for the additional reasons that the taxpayer did not prove that the alleged sale in 1952 of the timber property constituted a closed transaction in that year, that the alleged loss on the sale of the sawmill was incurred in a transaction entered into for profit, and that he fully owned the properties upon which his loss is based, the taxpayer is not entitled to any loss deduction for the year 1952 as a result of his investment in Eagle Timber.

2. The taxpayer also claims that he sustained a loss in 1951, which he alleges was incurred in his business as a practicing attorney, and therefore that he is entitled to a deduction under Section 23(e)(1)

of the 1939 Code. The Tax Court found as a fact, however, that the claimed loss was essentially a personal one, sustained by the taxpayer solely to protect his person from the threats of racketeers to whom the payments were made, and denied the deduction. Since the loss was in its nature personal, Section 24(a)(1) of the 1939 Code forbids its deduction "in any case". The question whether a loss or expense is personal is one of fact and the record here fully warrants the Tax Court's finding, which is not clearly erroneous. For the foregoing reason, as well as others fully discussed in Point II of our argument, the taxpayer is not entitled to the claimed deduction.

3. Although the taxpayer was required to file a declaration of estimated tax for the year 1952 he failed to do so. Section 294(d)(1)(A) of the 1939 Code exacts an addition to tax from any taxpayer who fails to file a declaration on time. The addition to tax is mandatory "unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect". The Commissioner was not satisfied that the taxpayer's failure to file a declaration for 1952 at any time, late or otherwise, was due to reasonable cause. The Tax Court found as a fact that the taxpayer's failure to file a declaration was not due to reasonable cause and, in accordance with the statutory mandate, decided that the taxpayer was liable for the addition to tax. The question here is one of fact and the burden of proof is upon the taxpayer; since the record fully supports the Tax Court's finding, the taxpayer's contention that it is clearly erroneous is without merit.

ARGUMENT

I

The Tax Court's Finding That the Taxpayer Did Not Carry His Burden of Proving That He Realized a Loss In the Taxable Year 1952 As a Result of Transactions In Connection With Eagle Timber and Mill Company Is Fully Supported By the Record and Not Clearly Erroneous

A. *Introduction*

Eagle Timber was incorporated as a Washington corporation on October 22, 1946. (R. 109.) On October 24, 1946, the taxpayer contributed timber property to Eagle Timber and prior to February 3, 1947, he contributed a sawmill to that corporation. (R. 108-109.) In May, 1950, Herbert D. Norris sold his interest in Eagle Timber to the taxpayer and the taxpayer assumes that that resulted in his complete ownership of the corporation. (R. 98, 110-111; Br. 61-62.) The taxpayer argues that his total investment in Eagle Timber was as follows (Br. 61):

Amounts paid for properties transferred to Eagle Timber (see R. 111)	$20,556.60
Payment to Herbert D. Norris for his interest in Eagle Timber	2,000.00
Paid to clear Eagle Timber's property from liens	11,083.34
Total	$33,639.94

On July 1, 1950, Eagle Timber was dissolved by operation of law for failure to pay license fees. (R. 112.) The taxpayer contends (Br. 61) that in 1952 he sold the property that he had previously received upon the dissolution of the corporation and recov-

ered as a result thereof $14,500; accordingly, he argues that he suffered an ordinary loss of $19,-139.94, the difference between the amount of his investment and his recovery upon the sale of the properties mentioned.

In the Tax Court the taxpayer argued that his loss constituted a business bad debt loss, deductible in full under Section 23(k)(1) of the 1939 Code (Appendix, *infra*), or that the loss was incurred in a transaction entered into for profit, deductible in full as an ordinary loss under Section 23(e)(2) (Appendix, *infra*). (R. 107.) The Tax Court found as a fact (R. 118, 123-124) that the taxpayer's outlays to and on behalf of Eagle Timber did not constitute debts but were investments; that is, that they constituted contributions to the capital of Eagle Timber. In this Court the taxpayer does not contend that that finding is clearly erroneous, since the record fully supports it, and he agrees that the advances were *investments* in the venture. (Brief *in toto.*) The taxpayer's position is apparently that Eagle Timber should not be recognized as a taxable entity distinct from himself, and therefore its business should be considered his business and any loss as a result of the venture should be allowed in full, either as a business loss under Section 23(e)(1) or as a loss from a transaction entered into for profit under Section 23(e)(2). As we shall show in the following discussion, the taxpayer's arguments are without merit.

It should be noted here that if the Tax Court's findings (R. 122-124), that Eagle Timber must be

recognized as a taxable entity for tax purposes and that the taxpayer's advances constituted capital contributions to the corporation, are correct then the taxpayer is not entitled to an ordinary loss deduction in any event. The loss would not be a business loss under Section 23(e)(1) because a corporation, taxwise, is to be treated as a separate and distinct entity from the individual who owns it, and its business cannot be appropriated by the owner unto himself. See subpoint B, *infra.*[4] Moreover, the fact that

[4] The only instances in which a taxpayer who owns a corporation recognized as a tax entity can take a business loss deduction for his financing of the corporation, either by way of *loans* or contributions to capital, are where (1) he is in the business of loaning money, or (2) he is in the business of promoting, financing, and managing business enterprises. *Holtz* v. *Commissioner,* 256 F.2d 865, 870 (C.A. 9th); *Skarda* v. *Commissioner,* 250 F. 2d 429, 435 (C.A. 10th); *Wheeler* v. *Commissioner,* 241 F. 2d 883, 884 (C.A. 2d); *Hickerson* v. *Commissioner,* 229 F. 2d 631, 634 (C.A. 2d); *Berwind* v. *Commissioner,* 20 T.C. 808, 815, affirmed *per curiam,* 211 F. 2d 575 (C.A. 3d). The taxpayer did *not* contend before the Tax Court, nor does he contend here, that he was in any of these businesses in the year of the alleged losses, and the record clearly would not support such contention. The record merely shows that since 1934 the taxpayer was associated with several corporations merely as an employee, liquidating trustee, or officer, and that he invested in several corporations as a stockholder. (R. 47-49.) It is well settled that such activities are not sufficient to create separate businesses for a taxpayer so that his loss from an investment in a corporation may be considered a business loss. Indeed, the taxpayer on his tax returns for 1951 and 1952 stated that his only business was that of an attorney. (Exs. 1-A, P.) The courts have uniformly disallowed business losses in cases parallel to this one but involving more extensive activities than were here involved. *Dalton* v. *Bowers,* 287 U.S. 404; *Holtz* v. *Commissioner, supra; Koch* v.

a loss is incurred in an alleged transaction entered into for profit under Section 23(e)(2) does not of itself permit a deduction of the loss in full. An individual taxpayer in order to deduct losses must bring his transaction within one of the provisions of Section 23(e); however, the amount of the loss allowed as a deduction is limited by other subsections of Section 23. Since the Tax Court found (R. 124) that the advances were investments in Eagle Timber, and the investments were not held for sale to customers in the ordinary course of a trade or business and were not inventory property, they constituted capital assets, and upon liquidation of the corporation any loss must be taken only as a capital loss as a result of a sale or exchange of a capital asset. Sections 23(g), 115(c), and 117 of the 1939 Code (Appendix, *infra*); *Electro-Chemical Co.* v. *Commissioner*, 311 U.S. 513; *Helvering* v. *Hammel*, 311 U.S. 504; *White* v. *United States*, 305 U.S. 281; *Martin General Agency* v. *Commissioner*, 101 F. 2d 165 (C.A. 9th); *Feine* v. *McGowan*,

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United States (C.A. 9th), decided September 12, 1958 (58-2 U.S.T.C., par. 9831), certiorari denied, 358 U.S. 945; *Hickerson* v. *Commissioner, supra; Berwind* v. *Commissioner, supra; Towers* v. *Commissioner,* 24 T.C. 199, affirmed, 247 F.2d 233 (C.A. 2d), certiorari denied, 355 U.S. 914; *Wheeler* v. *Commissioner,* decided May 27, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,138), affirmed *per curiam,* 241 F.2d 883 (C.A. 2d); *Commissioner* v. *Smith,* 203 F.2d 310 (C.A. 2d), certiorari denied, 346 U.S. 816. See *Higgins* v. *Commissioner,* 312 U.S. 212; *Continental Trading, Inc.* v. *Commissioner* (C.A. 9th), decided March 10, 1959 (59 U.S. T.C., par. 9316).

188 F. 2d 738 (C.A. 2d); *Culley* v. *Commissioner*, 29 T.C. 1076; Section 29.23(e)-1, Treasury Regulations 111 (Appendix, *infra*). And, of course, any loss in this case on the subsequent sale of the property received by the taxpayer by virtue of the liquidation would likewise result from the sale or exchange of a capital asset and be subject to the limitations of the capital loss provisions (Secs. 23(g) and 117 of the 1939 Code).

B. ***Eagle Timber was a corporate entity for tax purposes and may not be disregarded by its owner merely to obtain tax advantages***

The present case belongs to a long line of cases dealing with the question whether a business unit should be recognized or disregarded for purposes of the taxing law. This case presents the usual situation where the taxpayer-owner of a corporation contends (Br. 55-57) that in order to improve his position tax-wise he can disregard the corporation, and that the Tax Court as a matter of law was compelled to adopt his contention, although the corporation was created for business purposes, actually conducted business transactions, and was represented to the public as a corporation.

The difficulty with this position is that, as we shall show, the decided cases uniformly hold that taxpayers cannot disregard a corporate entity where the purpose of its creation was to engage in business activities *or* it actually was used in business transactions.

We start with the general rule that a corporation, tax-wise, is to be treated as an entity separate

and distinct from the individuals who own it. *Burnet* v. *Commonwealth Imp. Co.*, 287 U.S. 415, 419; *Burnet* v. *Clark*, 287 U.S. 410, 415; *Dalton* v. *Bowers*, 287 U.S. 404, 410. There is, however, an exception, and the entity may be disregarded *only* where (1) the purpose for its creation was not a business purpose, *and* (2) its creation was not followed by any business activity. *Estate of Whitfield* v. *Commissioner*, 14 T.C. 776, affirmed, 192 F. 2d 494 (C.A. 5th); *Paymer* v. *Commissioner*, 150 F. 2d 334 (C.A. 2d). Where, however, the purpose for the creation of the corporation is a business one *or* the creation is followed by business activity, the corporation cannot be disregarded. *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 428-429; *Moline Properties* v. *Commissioner*, 319 U.S. 436, 439; *Skarda* v. *Commissioner*, 250 F. 2d 429, 433-434 (C.A. 10th); *Jackson* v. *Commissioner*, 233 F. 2d 289, 290 (C.A. 2d); *Buckley* v. *Commissioner*, 231 F. 2d 204 (C.A. 2d); *Palcar Real Estate Co.* v. *Commissioner*, 131 F. 2d 210, 212 (C.A. 8th); *Love* v. *United States*, 96 F. Supp. 919, 921 (C. Cls.); *Gray Holding Corp.* v. *Clawson*, 95 F. Supp. 928, 933-935 (Maine).

The Supreme Court has admonished taxpayers that, under the circumstances last discussed, the corporation they have created remains a distinct entity notwithstanding the purely utilitarian and *alter ego* aspects of its existence (*National Carbide Corp.* v. *Commissioner*, *supra*, pp. 428-429), and the facts that the individual owners retain direction down to the minutest detail, provide all the assets, and take all the profits are immaterial tax-wise (*National Car-*

bide Corp. v. *Commissioner, supra,* pp. 431-432). This principle applies though the corporate structure itself is incomplete (e.g., where there are no certificates of ownership actually issued, no corporate employees, no meetings of directors or shareholders, and no corporate books), but the business entity is held out to the public as a corporate body and in fact there are transactions in the name of the corporations. *Skarda* v. *Commissioner, supra; Estate of Whitfield* v. *Commissioner, supra; L. T. Campbell, Inc.* v. *Commissioner,* 159 F. 2d 629 (C.A. 5th); *Halprin* v. *Commissioner,* decided July 23, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,-254), affirmed *per curiam,* 154 F. 2d 112 (C.A. 2d); *Paymer* v. *Commissioner, supra; Love* v. *United States, supra.* Cf. *Maletis* v. *United States,* 200 F. 2d 97, 98 (C.A. 9th), certiorari denied, 345 U.S. 924.

In short, the taxing law does not permit taxpayers who commence business through corporations, or create corporations for valid business purposes, and, if all goes well, will realize the income tax and business advantages, to disclaim the business form created merely because it turns out to be a tax disadvantage. *National Carbide Corp.* v. *Commissioner, supra,* pp. 428-429; *Moline Properties* v. *Commissioner, supra,* p. 439; *Skarda* v. *Commissioner, supra,* p. 434; *Palcar Real Estate Co.* v. *Commissioner, supra,* p. 212; *Vim Securities Corp.* v. *Commissioner,* 130 F. 2d 106, 109 (C.A. 2d), certiorari denied, 317 U.S. 686; *Love* v. *United States, supra,* p. 921. Cf. *Maletis* v. *United States, supra.*

In the present case, Eagle Timber's existence as a corporate entity began in the State of Washington on October 22, 1946. (R. 109; Exs. 4 and D.) There were three directors or trustees of the corporation, namely, the taxpayer, his first wife, Phoebe, and one Tim Healy. (Ex. 4.) The capital of the corporation consisted of a sawmill and equipment and timber properties. (R. 108-109, 122-124.)

The business purposes of the corporation were stated in its articles of incorporation to be: to engage in a general logging, milling, plywood, timber, and lumber business, and to do all things relative or incidental thereto. (R. 109; Ex. 4.)

Subsequent to incorporation Eagle Timber, in its corporate name, entered into a logging contract with L. E. Peterson & Son. (Ex. 5, Washington Title Insurance Company report.) The corporation as a legal entity purchased property from the United States Forest Service. (Ex. C.) Eagle Timber borrowed money in December, 1946, executing its note and a mortgage on its property as security therefor. (R. 109; Ex. 8.) On February 3, 1947, the corporation, in its corporate name, again borrowed money, executing a real estate and chattel mortgage as security for its promissory note. (R. 110; Ex. G.) On July 24, 1948, Eagle Timber entered into a contract to sell its timber property. (R. 111.) In 1948 Eagle Timber was a party to a law suit in the Washington courts and a judgment was recovered against it as a corporate entity. (R. 111; Ex. 5, Washington Title Insurance Company report.)

Eagle Timber was held out to the public by the taxpayer as a Washington corporation. The taxpayer asserted to those dealing with the corporation that he was its president, and contracts were executed by him as president and his former wife, Phoebe, as secretary of the corporation. (R. 78, 98; Exs. E, F, G, 2-B, 3.) The taxpayer, under *oath*, asserted that Eagle Timber was a corporate entity and that he acted as its president when, on February 3, 1947, he executed a real estate and chattel mortgage for that corporation. (Ex. G.) On tax returns the taxpayer asserted that Eagle Timber was a distinct legal entity, and, in his original petition before the Tax Court, he made the same assertion. (R. 7; Exs. 1-A, E.)

It is difficult to conceive of a more appropriate case calling for the application of the principle that, while a taxpayer is free to adopt such organization for his affairs as he may choose, he is not free, after having chosen the corporate form, to disregard the arrangement whenever it is to his tax advantage to do so.[5]

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[5] In *Skarda* v. *Commissioner*, 250 F.2d 429, 432 (C.A. 10th), there were no meetings of stockholders of the corporation; the corporation adopted no by-laws; there were no officers *formally* elected; no minute books were kept, no corporate stock was issued; and no property was *formally* transferred to the corporation by its taxpayer-owners. The taxpayers contended (p. 433) that the corporation never came into existence, or that if it did it should be disregarded as a sham. The Tenth Circuit ruled (pp. 434-435) that, although directors and officers were not formally elected, there were *de facto* officers and directors; that the corporation *in fact* acquired capital; and that failure to comply otherwise with local statutes did not prevent corporate existence but at

Moreover, we have here not only valid and true business purposes for the creation of the corporation, to wit, to carry on timber transactions, but also actual business transactions in the corporate name to a

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most rendered the corporation one *de facto* rather than *de jure*. The court concluded that, since the corporation was created for a business purpose and/or since transactions were had in the corporate name, the corporation could not be disregarded for tax purposes.

In *L. T. Campbell, Inc.* v. *Commissioner,* 159 F. 2d 629 (C.A. 5th), the taxpayer claimed that the corporate charter was unused, nothing had been done to complete the corporate structure, no corporate assets had been acquired, no franchise tax paid, no books of account kept, and no corporate officers functioned, and that, therefore, the corporate entity should be disregarded. There was business activity carried on in the name of the corporation. Although there was no formal transfer of property to the corporation, it was shown that those who acted for the corporation used certain property and listed it as corporate property. Corporate books were in fact kept, and it was held out to the world that the taxpayers were doing business for the corporation. The Court of Appeals affirmed the Tax Court's finding that for tax purposes the business was that conducted by a corporation and that the corporate entity could not be disregarded.

In *Paymer* v. *Commissioner,* 150 F. 2d 334 (C.A. 2d), there were two corporations, Raymep and Westrich. The corporations never held meetings, no officers were elected after a president and treasurer were appointed, and there were no corporate bank accounts and no office. The partners who created the corporations managed the real estate that was transferred to the corporations, collected the income, and paid expenses. Raymep, however, obtained a loan in its name and provided security for the loan. It was held that Westrich was a sham but that Raymep had to be recognized as a separate entity for tax purposes since, although organized merely to deter creditors, it was impracticable to use it solely for that purpose when it was desired to obtain a loan. This activity was sufficient business to bring Ray-

greater extent than in several of the cases cited in footnote 5 below wherein it was held that the corporation could not be disregarded for tax purposes. Various loans were transacted, purchases were made,

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mep within the general rule forbidding the disregarding by taxpayers of a corporation which they used to transact business.

In *Halprin* v. *Commissioner*, decided July 23, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,254), affirmed *per curiam*, 154 F. 2d 112 (C.A. 2d), the corporation was organized to hold title to real property, no certificates of stock were issued, the corporation never had employees, never held meetings, never had a bank account, and never had any capital other than the real estate. However, the property was rented and transactions concerning mortgages, taxes, and insurance were had in the corporate name. It was held that the corporation served its purpose, that the activity was a business activity, and that, therefore, it must be recognized for tax purposes.

In *Palcar Real Estate Co.* v. *Commissioner*, 131 F. 2d 210 (C.A. 8th), the corporation executed a note and a mortgage in its name and there was a corporate bank account. It was held that the corporation could not be declared a nominality for income tax purposes.

In *Sheldon Bldg. Corp.* v. *Commissioner*, 118 F. 2d 835 (C.A. 7th), the corporation held a bank account and entered into leases; it was held that since there was business activity in the name of the corporation it could not be considered a sham.

In *Love* v. *United States*, 96 F. Supp. 919 (C.Cls), the corporation had no capital stock paid in, it never owned a bank account, and it kept no books of account. However, the corporation leased property, executed deeds, filed federal social security tax returns which reported employer and employee taxes, and it paid United States unemployment taxes. It was held that there was business activity carried on through the corporation and therefore the corporation remained a distinct entity for tax purposes.

These cases are indicative of the uniform judicial application of the principles involved in the present case.

contracts were entered into, and mortgages and deeds were executed, all in the corporate name. Under the authorities previously discussed this record is ample support for the finding of the Tax Court (R. 118) that, for tax purposes, the corporation was a separate entity from the individual who owned it.

The taxpayer, however, asserts (Br. 35-50) that there was no corporation tax-wise because there were no directors or officers, and there was no issuance of stock and no acquisition of capital. This contention has no merit.

Section 23.01.050(2) of 2 Revised Code of Washington (Appendix, *infra*) provides that upon the issuance of the certificate of incorporation "the corporate existence shall begin", and Section 23.01.090 of that Code (Appendix, *infra*) provides that the certificate of incorporation issued by the secretary of state "shall be conclusive evidence of the fact that the corporation has been incorporated."

In this case the triplicate originals of articles of incorporation were filed with the Secretary of the State of Washington, at Olympia, Washington; all taxes, fees, and charges were paid; and the Secretary of State endorsed his approval and filed the articles on October 22, 1946. One set of the articles was then filed in the office of the auditor of King County, the county in which the registered office of the corporation was situated, and the other set of articles was retained by the corporation. Filing fees were also paid to King County. (R. 53-54, 109; Ex. 4.) This was complete compliance with Section 23.01.050 of 2 Revised Code of Washington, and therefore the

corporation was an existing entity under local law as of October 22, 1946. Indeed, a signed and sealed certificate from the Secretary of State of Washington, introduced into evidence as Exhibit D (R. 91), states that Eagle Timber was incorporated on October 22, 1946. Moreover, the articles of incorporation were introduced in evidence as Exhibit 4 (R. 53-54) and that is conclusive evidence under local law of the fact that the corporation had been incorporated. Section 23.01.090 of 2 Revised Code of Washington. Thus, it would appear that the corporation was one *de jure* since all conditions precedent to corporate existence were complied with. Its existence was to be perpetual (Ex. 4, p. 1), and it did not cease to be a corporate entity until July 1, 1950, when it was dissolved for failure to pay license fees. (R. 112).

The taxpayer, however, contending that Eagle Timber was not given capital, relies (Br. 19, 44-50) upon Section 23.01.080(1) of 2 Revised Code of Washington (Appendix, *infra*) for his theory that no corporation existed. That section sets out prerequisites for a corporation's commencement of business. Those requirements are that (a) a triplicate original of the articles of incorporation must have been filed in the office of the county auditor; [6] (b) the amount of paid-in capital with which it will begin business, as stated in the articles of incorporation, has been fully paid; and (c) there must be filed

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[6] It is conceded that this requirement was satisfied. (R. 53-54, 109.)

in the office of the auditor of the county in which the corporation has its registered office an affidavit by directors stating that the amount of paid-in capital as stated in its articles of incorporation has been fully paid. The only penalty the statute exacts for failing to conform with that section is that officers may be held liable for corporate debts. On the other hand, stockholders remain protected by the corporate entity, and the existence of the corporation is not at all affected. The taxpayer's contention (Br. 44-50) that Eagle Timber had no capital is erroneous because, as we will point out below, the record *in fact* establishes, and the Tax Court found as a fact, that that corporation was given capital (R. 118, 123-124), and the finding is supported by the evidence and certainly is not clearly erroneous.

The record here discloses that the taxpayer purchased timber property and had the vendors transfer the property to the corporation on October 24, 1946. The statutory warranty deed naming Eagle Timber as grantee and the bill of sale were filed with the auditor of King County, Washington, on January 6, 1947. (R. 108; Exs. 2-B, 3.) A title insurance company's report which was written on September 8, 1951, shows that title to the property was in the corporation. (Ex. 5, Washington Title Insurance Company report.) Moreover, in subsequent transactions Eagle Timber mortgaged the property on several occasions in order to obtain loans. (R. 109-110.) The taxpayer also transferred a sawmill to the corporation prior to February, 1947. (R. 109.) The corporation subsequently mortgaged the sawmill

in order to obtain a loan and the mortgage provided that Eagle Timber, a Washington corporation, owned this property. (R. 110.) Indeed, in 1948 Eagle Timber attempted to sell the sawmill and the timber to Sterling Timber and Lumber Company for $90,-000, in which contract it is stated that title to all the property is in Eagle Timber, and it was signed for Eagle Timber by the taxpayer as an officer of the corporation. (R. 111; Ex. C.) Moreover, judgments recovered against Eagle Timber, as a corporation, were liens on the property. (Ex. 5, Washington Title Insurance Company report.) In view of the foregoing, we submit that the Tax Court's finding (R. 118, 122-124) that the property discussed belonged to Eagle Timber is unassailable.

The required amount of capital was stated in the certificate of incorporation to be $500 (Ex. 4) and the corporation was given capital before February, 1947, which was apparently worth thousands of dollars more than $500. This was substantial compliance with the statutory requirement in question. *Skarda* v. *Commissioner*, 250 F. 2d 429, 435 (C.A. 10th).

But even if, *arguendo*, we consider the paid-in capital not substantial compliance with Section 23.01.080 (1) of 2 Revised Code of Washington because the directors did not file an affidavit stating that at least $500 worth of capital had been paid in, this at most would render the corporation one *de facto*,[7] subject

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[7] Substantial compliance with local statutes will make a corporation *de jure*. But the failure of some substantial requirement, although preventing the body from being *de jure*,

only to a direct attack by the state. The same observation applies to the taxpayer's other contentions (Br. 38-44) that no corporation existed because no stock was issued, no meetings were held, etc. It should be noted that the failures of compliance relied upon by the taxpayer do not, under the Revised Code of Washington, end corporate existence. Indeed, the taxpayer's entire argument fails to recognize well-established distinctions. The applicable principle is stated in *Skarda* v. *Commissioner*, *supra*, as follows (p. 435) —

> statutory conditions to the right to engage in business [or other conditions], to be performed after the corporation has been formed, are conditions subsequent, and while a noncompliance therewith may give the state a right to proceed to forfeit the franchise, such noncompliance in the absence of such proceeding does not in anywise affect the legal existence of the corporation.

In accord are: *Wells Co.* v. *Gastonia Co.*, 198 U.S. 177, 185-186; *Refsnes* v. *Myers*, 164 Wash. 205, 209-210, 2 P. 2d 656, 657; *Carroll* v. *Pacific National Bank*, 19 Wash. 639, 641, 54 Pac. 32, 33; *Pierce Co. Dairymen's Ass'n* v. *Templin*, 124 Wash. 567, 571-572, 215 Pac. 352, 353-354; *American Radiator Co.* v. *Kinnear*, 56 Wash. 210, 212-213, 105 Pac. 630, 631; *Spokane* v. *Amsterdamsch Trustees Kantoor*, 22 Wash. 172, 178, 60 Pac. 141, 143; *Midwest Air Filters Pacific, Inc.* v. *Finn*, 201 Cal. 587, 592-593,

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will not prevent the corporation from being *de facto* where there is user pursuant to attempted organization. *Henry* v. *Markesan State Bank*, 68 F. 2d 554, 558 (C.A. 8th).

258 Pac. 382, 384-386; *Drake Hotel Co.* v. *Crane*, 210 Mo. App. 452, 240 S.W. 859; *Murdock* v. *Lamb*, 92 Kan. 857, 142 Pac. 961; 8 Fletcher, Cyclopedia of Corporations (Revised and Permanent ed., 1931), Sec. 3802 (p. 108).

In *Skarda* v. *Commissioner*, 250 F. 2d 429, the Tenth Circuit held that the corporation whose existence was there being questioned was at least a *de facto* corporation, required to be recognized as a distinct entity, separate and apart from the taxpayers who owned it. This was so held even though there were (p. 432) no meetings of stockholders or directors, no by-laws adopted, no officers formally elected, no corporate stock issued, no minute books kept, and no property was formally transferred to the corporation. The present case is stronger for that conclusion than was *Skarda* because here we have among other things, property that was formally transferred to the corporation while in *Skarda* it was necessary for the court to determine from all the facts (pp. 434-435) that the corporation received capital from its owners.

Further, it should be noted that, quite contrary to the taxpayer's assertions (Br. 38-44), the record shows that Eagle Timber had directors or trustees and officers authorized to act for it. The articles of incorporation named the taxpayer and Phoebe (his former wife) and one Healy as trustees or directors until their successors should be elected and qualified. (Ex. 4, p. 2.) So far as the record indicates, all parties interested in the corporation authorized the taxpayer to act as its president and Phoebe to act

as its secretary. (See R. 78, 112; Exs. B, C, G and 8.) Accordingly, the taxpayer and Phoebe acted as president and secretary of Eagle Timber in all business transactions and they were held out to the public as such representatives. Thus, the directors and officers, authorized to act as such by the articles of incorporation, and with tacit consent of all interested as well as disinterested parties, held over without challenge, discharging the duties of their offices in conducting the corporate affairs in accordance with the articles of incorporation.

It needs little citation of authority to show, and it is too well settled to dispute, that under these circumstances the directors and officers of the corporation, if not *de jure* were at least *de facto*, having the same rights and authority as officers *de jure*. *Independence Lead Mines Co.* v. *Kingsbury*, 175 F. 2d 983, 985-986 (C.A. 9th), certiorari denied, 338 U.S. 900; *Pacific State Bank* v. *Coats*, 205 Fed. 618, 621 (C.A. 9th); *Skarda* v. *Commissioner*, *supra*, pp. 434-435; *Spokane* v. *Amsterdamsch Trustees Kantoor*, 22 Wash. 172, 177, 60 Pac. 141, 143. Moreover, a failure to elect directors or officers will not prevent the existence of at least a *de facto* corporation. *Drake Hotel Co.* v. *Crane*, 210 Mo. App. 452, 240 S.W. 859.

To summarize, in the case at bar there were *in fact* directors and officers of the corporation; there were, in fact, thousands of dollars worth of capital in the corporate name; the articles of incorporation certified that each of the incorporators subscribed for stock (Ex. 4); and corporate powers were exercised.

It appears, therefore, that there was substantial compliance with local statutes so that the corporate entity was one *de jure*. But, if there is any doubt about this, Eagle Timber was certainly a *de facto* corporation, subject only to a direct attack by the state, and, as the record shows (R. 112; Ex. D), the state never questioned its right to do business, no less its existence, until July 1, 1950, when the corporation was dissolved for failure to pay annual corporate license fees (R. 112). Furthermore, for tax purposes, the courts have uniformly refused to disregard corporate entities in cases where their organization was incomplete but there was, as here, a business purpose for incorporation or transactions were executed in the corporate name. See fn. 5, *supra*.

C. ***The Tax Court's findings, that the taxpayer's contributions to Eagle Timber were contributions to its capital and that the taxpayer did not prove that he realized a loss when he allegedly sold property that he had previously received upon the liquidation of that corporation, are not clearly erroneous***

As noted, under Point I-A, *supra*, the taxpayer contended in the Tax Court that his advances to Eagle Timber constituted debts but the Tax Court found that they were contributions to capital. (R. 124.) The question whether advances to a corporation constitute loans or contributions to capital is one of fact. *Earle* v. *W. J. Jones & Son*, 200 F. 2d 846, 847 (C.A. 9th); *Bair* v. *Commissioner*, 199 F. 2d 589, 591 (C.A. 2d); *Powers Photo Engraving Co.* v. *Commissioner*, 197 F. 2d 704, 705 (C.A. 2d); *Gooding Amusement Co.* v. *Commissioner*, 236 F. 2d 159,

166 (C.A. 6th), certiorari denied, 352 U.S. 1031. The present record shows that Eagle Timber had *no* capital before the taxpayer transferred the sawmill and the timber property to it. (R. 108-109). The corporation's business purpose was to engage in the timber business (Ex. 4), and the property thus transferred to it was necessary to that business. There were no notes evidencing that Eagle Timber was obligated to the taxpayer, and no interest, so far as the record shows, was promised or accrued to the taxpayer. The taxpayer did not testify that he expected to be repaid other than as an investor. Likewise, a fact of great importance to a finding of a debt was not shown to exist, to wit, that there was a fixed date for repayment or within which to demand repayment. *241 Corp.* v. *Commissioner*, decided July 25, 1956 (1956 P-H T.C. Memorandum Decisions, par. 56,174), affirmed *per curiam*, 242 F. 2d 759 (C.A. 2d), certiorari denied, 354 U.S. 938; *May Hosiery Mills* v. *Commissioner*, 123 F. 2d 858, 860 (C.A. 4th); *Haffenreffer Brewing Co.* v. *Commissioner*, 116 F. 2d 465, 468 (C.A. 1st), certiorari denied, 313 U.S. 567; *Jewel Tea Co.* v. *United States*, 90 F. 2d 451, 453 (C.A. 2d).

Considering all the factors in the record, the situation is clearly that of a taxpayer investing in a corporate venture, taking the risk of losses so that he may enjoy the profits. Any loss as a result of the investment would, therefore, be a loss of venture capital, not deductible as a bad debt. *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 435, fn. 16; *Root* v. *Commissioner*, 220 F. 2d 240, 241 (C.A.

9th); *Schnitzer* v. *Commissioner*, 13 T.C. 43, 62, affirmed *per curiam*, 183 F. 2d 70 (C.A. 9th), certiorari denied, 340 U.S. 911; *Dobkin* v. *Commissioner*, 15 T.C. 31, affirmed *per curiam*, 192 F. 2d 392 (C.A. 2d); *Cohen* v. *Commissioner*, 148 F. 2d 336, 337 (C.A. 2d); *Thomas* v. *Commissioner*, 2 T.C. 193, 196; *Kalech* v. *Commissioner*, 23 T.C. 672, 680-681. As we have previously pointed out, the taxpayer does not contest the finding of the trial court that the contributions constituted an investment, and the record fully supports that finding.[8]

The second issue to be discussed here is a contested one; it is whether the taxpayer proved that he realized a loss in 1952. The taxpayer bears the burden of proof in showing that a loss was sustained in the year for which he claims a deduction, and the question is one of fact, subject to the clearly erroneous rule. *Boehm* v. *Commissioner*, 326 U.S. 287, 293, rehearing denied, 326 U.S. 811; *Burnet* v. *Houston*,

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[8] Since the Tax Court found that the contributions were investments, its additional finding (R. 124) that the contributions were not debts is also clearly correct. It is well settled that subsections (e) and (k) of Section 23 of the 1939 Code are mutually exclusive, and a loss which in its nature is due to an investment must be taken as a deduction under subsection (e) or not at all. See *Putnam* v. *Commissioner*, 224 F. 2d 947 (C.A. 8th), affirmed, 352 U.S. 82; *Spring City Co.* v. *Commissioner*, 292 U. S. 182. Moreover, it should be noted that in no event could the Tax Court have considered $2,000 of the alleged $19,139.94 loss to be a debt, since it was paid merely to purchase another stockholder's interest in Eagle Timber. (R. 110-111.) The other shareholder was Mr. Norris who apparently was considered half owner of the corporation. (R. 57.)

283 U.S. 223, 227; *Finney* v. *Commissioner*, 253 F. 2d 639, 641-642 (C.A. 9th). The taxpayer concedes (Br. 58) that if the timber and sawmill were properties belonging to Eagle Timber, then when Eagle Timber was dissolved on July 1, 1950, the taxpayer received, as the Tax Court found (R. 125), a liquidating dividend and the amount so distributed to him must be treated by him as in full payment in exchange for his interest in Eagle Timber. As we have shown in subpoint B, *supra*, the Tax Court properly found that the timber and sawmill constituted property belonging to the corporation. The finding that a distribution was made in liquidation of a corporation is one of fact (*Gensinger* v. *Commissioner*, 208 F. 2d 576, 583 (C.A. 9th); *Holmby Corp.* v. *Commissioner*, 83 F. 2d 548, 549-550 (C.A. 9th); *Transportation Service Associates, Inc.* v. *Commissioner*, 149 F. 2d 354, 355 (C.A. 3d)), and the taxpayer does not seriously controvert it.

Upon a liquidation of a corporation, gains or losses are taxed on the same basis as gains or losses upon sales or exchanges of property, and are subject to the capital gain or loss provisions of the revenue statutes. Sections 23(g), 115(c), and 117 of the 1939 Code; *White* v. *United States*, 305 U.S. 281; *Martin General Agency* v. *Commissioner*, 101 F. 2d 165 (C.A. 9th); Rev. Rul. 55-737, 1955-2 Cum. Bull. 570. Accordingly, as the Tax Court held (R. 125), the taxpayer realized in 1950 a gain or loss when he acquired the timber and sawmill properties in liquidation, based upon the adjusted basis of his investment in Eagle Timber and the fair market value of

the property acquired at the time of the distribution. Section 111(b) of the 1939 Code (Appendix, *infra*); *Westover* v. *Smith*, 173 F. 2d 90, 92 (C.A. 9th); *Fleming* v. *Commissioner*, 153 F. 2d 361, 363 (C.A. 5th). Upon the subsequent alleged sale of the property in 1952 (R. 125) his cost or basis for determining gain or loss was, therefore, its fair market value at the time acquired. See *Florida Machine & Foundry Co.* v. *Fahs*, 73 F. Supp. 379, 381 (S.D. Fla.), affirmed, 168 F. 2d 957 (C.A. 5th); *McCullough* v. *Commissioner*, 153 F. 2d 345, 347 (C.A. 2d); *Bennett* v. *Commissioner*, 139 F. 2d 961, 964-965 (C.A. 8th); *Gloyd* v. *Commissioner*, 19 B.T.A. 966, 968, affirmed, 63 F. 2d 649 (C.A. 8th), certiorari denied, 290 U.S. 633; *Cerro De Pasco Copper Corp.* v. *United States*, 13 F. Supp. 633, 639 (C. Cls.), certiorari denied, 298 U.S. 686; *Feathers* v. *Commissioner*, 8 T.C. 376, 382; *Anderson* v. *Commissioner*, 19 B.T.A. 371, 375; *Staley* v. *Commissioner*, 15 B.T.A. 625, 626. The taxpayer is familiar with this principle and used it in computing his gain from the sale of property which he had received upon liquidation of another corporation. (Ex. O.)

The taxpayer introduced no evidence with respect to the fair market value of the properties in 1950, and hence it is impossible to determine whether or not a loss was realized in 1952, the year for which he claims the deduction. Although he was given notice by the Commissioner in 1955 that he would have to prove his basis for the property in order to establish a loss (R. 12), yet at the trial below he did not testify as to the fair market value of the

timber and sawmill in the year 1950, nor did he have any witnesses, expert or otherwise, testify with respect to such value.

In order to determine a loss under Section 23(e) of the 1939 Code the statute makes it absolutely necessary for the taxpayer to prove his basis, and if he does not do so before the trial court he is not entitled to a deduction. Proof of basis is a specific fact which the taxpayer has the burden of proving. *Burnet* v. *Houston*, 283 U.S. 223, 228-229; *Long* v. *Commissioner*, 96 F. 2d 270, 272 (C.A. 9th), certiorari denied, 305 U.S. 616; *Gulf, M. & N. R. Co.* v. *Commissioner*, 83 F. 2d 788, 791 (C.A. 5th), certiorari denied, 299 U.S. 574; *McGinley Corp.* v. *Commissioner*, 82 F. 2d 56, 58 (C.A. 5th). In this case the taxpayer's evidence on the point is non-existent and therefore the presumption in favor of the Commissioner's determination was never rebutted. Further, even if we examine the record without considering the presumption of correctness of the Commissioner's determination, it is clear that the taxpayer did not prove his basis in the properties so as to enable the Tax Court to determine that he realized a loss in 1952, and, accordingly, the Tax Court's finding on this factual question cannot be assailed as clearly wrong.[9] *Boehm* v. *Commissioner*, *supra*, p. 294; *Burnet* v. *Houston*, *supra*, pp. 227-229; *Finney* v. *Commissioner*, 253 F. 2d 639, 641-642 (C.A. 9th);

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[9] This is not a case where the trial court found there was a loss and merely refused to allow a deduction of some portion thereof. Here, without proof of basis, as the Tax Court held (R. 125), it cannot be determined whether a loss was

Long v. *Commissioner*, 96 F. 2d 270, 272 (C.A. 9th), certiorari denied, 305 U.S. 616; *Royal Packing Co.* v. *Lucas*, 38 F. 2d 180, 181-182 (C.A. 9th); *Dab* v. *Commissioner*, 255 F. 2d 788, 790 (C.A. 2d); *Bennett* v. *Commissioner*, 139 F. 2d 961, 964-965 (C.A. 8th).

The taxpayer's suggestion (Br. 60-61) that there was no liquidation in 1950 when the corporation was dissolved, because local statutes with respect to distribution of such assets were not complied with, is interesting. Under Section 23.60.150 of 2 Revised Code of Washington (Appendix, *infra*), where a corporation is dissolved for nonpayment of fees, the directors hold its assets as trustees for the benefit of creditors and shareholders, to be disposed of in appropriate court proceedings. *Gamble* v. *Alder Group Mining & S. Co.*, 5 Wash. 2d 578, 105 P. 2d 811. The taxpayer, therefore, became a trustee of the corporate assets in 1950 for the benefit of creditors and himself, as sole owner of the corporation.

Whether or not a corporation has made a distribution of assets in liquidation is a question of federal and not state law. *Ward M. Canady, Inc.* v. *Commissioner*, 29 B.T.A. 355, 361, affirmed, 76 F. 2d 278 (C.A. 3d), certiorari denied, 296 U.S. 612. See *Gensinger* v. *Commissioner*, 208 F. 2d 576 (C.A. 9th). The question is whether in *fact* a distribution was made; here, the Tax Court found that there was a distribution. (R. 124-125.) *Holmby Corp.* v. *Com-*

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realized in 1952. *McGinley Corp.* v. *Commissioner, supra;* cf. *Chesbro* v. *Commissioner,* 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995.

missioner, 83 F. 2d 548, 549-550 (C.A. 9th). Moreover, since the taxpayer held the assets under local law as a trustee for the shareholders and not as trustee for the corporation, the tax law considers the shareholders as having received a distribution at the time the trust was created. *Hines* v. *United States*, 90 F. 2d 957, 958-959 (C.A. 7th), certiorari denied, 302 U.S. 756. Also, it would appear on this record that since the taxpayer was in effect trustee for himself, and since he testified that he considered the property as his own (R. 75), there was a distribution to him in *fact* in 1950 when he became a trustee. *Gensinger* v. *Commissioner*, *supra*.

However, if we give technical effect to local law, as the taxpayer seems to contend for (Br. 60-61), then he has clearly not established a loss in 1952. In that event, since the taxpayer was merely a trustee and no court proceedings were had to distribute the property, the record does not establish that there was a closed transaction which could establish a loss in 1952. For a loss to be deductible under Section 23(e) of the 1939 Code it must be evidenced by a closed and completed transaction. *Boehm* v. *Commissioner*, 326 U.S. 287, 291; *Stiver* v. *Commissioner*, 90 F. 2d 505, 507 (C.A. 8th). Proof of losses on an investment in a corporation may be shown in two ways: first, when the investment in the corporation is *disposed of;* secondly when the investment, in fact, becomes *totally worthless*. The revenue statute does not allow as a deduction partial losses as a result of mere diminution in value of an investment, and so long as it has value a de-

duction cannot be taken. *Jones* v. *Commissioner*, 103 F. 2d 681, 684-685 (C.A. 9th); *Royal Packing Co.* v. *Lucas*, 38 F. 2d 180, 181-182 (C.A. 9th); *875 Park Avenue Co.* v. *Commissioner*, 217 F. 2d 699, 701 (C.A. 2d); *Dresser* v. *United States*, 55 F. 2d 499, 510-512 (C. Cls.), certiorari denied, 287 U.S. 635. In this case, if there was no distribution of property in liquidation, then the taxpayer's investment was not disposed of and there was no closed transaction. See Section 115(c) of the 1939 Code. Further, as the record shows, the taxpayer's investment in Eagle Timber had not otherwise become totally worthless in 1952 (R. 112-114); although we cannot be sure as to the exact amount of money the taxpayer would receive upon a distribution, it was reasonably certain in 1952 that he would receive something, and hence his investment still had value in that year. Accordingly, no deduction is allowable in these proceedings.

D. *Other reasons for denying a deduction to the taxpayer for the year 1952*

1. We will first discuss the timber property. The taxpayer centends (Br. 62) that there was a completed or closed transaction with respect to the timber property because of an alleged sale for $2,000 in 1952. Aside from the fact that the taxpayer did not prove his basis for this property so that it could be determined whether he realized a loss, he cannot prevail because, in fact, there was no sale in 1952.

Where the identifiable event relied upon to establish a loss is a sale, the transaction must be one of

present sale, otherwise there is no closed transaction. *Stiver* v. *Commissioner*, 90 F. 2d 505, 508 (C.A. 8th); *Hanson* v. *Commissioner*, 23 B.T.A. 590, 601, 604. The evidence with respect to this transaction shows that the taxpayer received an *offer* of $2,000 in 1952 and received a check from the offerer for $500 on December 4, 1952, but the check was not to be cashed until the spring of 1953. (R. 63.) In the meantime, the taxpayer continued to pay taxes on the property. (R. 63.) In the spring of 1953 the other party decided that he did not wish to go through with the sale and the $500 was never cashed. (R. 63.) It is therefore clear that there was no executed or present sale in 1952. The other party never paid the purchase price, nor was be obligated to pay it; title to the property was never transferred; and none of the benefits or burdens of ownership were transferred. (R. 63.)

The only other method the taxpayer could use to establish a loss in 1952 would therefore be to show that he abandoned the property in that year and hence that it was absolutely worthless. Mere diminution in value, as previously discussed, gives rise to no loss in the absence of a closed transaction such as a sale or abandonment. Abandonment consists of two elements: (1) an affirmative act indicating abandonment; and (2) an intent to abandon—a clear and unmistakable affirmative act indicating a purpose to repudiate ownership. Both of these elements must occur in the taxable year for which the loss is claimed. *Beus* v. *Commissioner*, 261 F. 2d 176 (C.A. 9th); *Harriss* v. *Commissioner*, 143 F. 2d 279, 282

(C.A. 2d); *Helvering* v. *Jones*, 120 F. 2d 828, 830 (C.A. 8th), certiorari denied, 314 U.S. 661.

Here, as a matter of law, the taxpayer could not be held to have abandoned the property in 1952, since during that entire year either he was negotiating for the sale of the property or the property was subject to an executory contract for a sale, and he was paying taxes on the property. (R. 63, 112.) The property was, therefore, not abandoned and not worthless in 1952. As the taxpayer testified (R. 63), it was in 1953 when he first considered the property worthless and stopped paying taxes on it. The taxpayer may not, therefore, take any loss whatsoever with respect to the timber property for the taxable years involved in this proceeding.

2. Here we concern ourselves with the sawmill property. With respect to this property, as previously discussed, the taxpayer did not establish his basis, which is an essential fact in order to determine whether he realized a loss in 1952. But the taxpayer is not entitled to a loss deduction for other reasons equally as fatal. The taxpayer claims the loss as incurred in a transaction entered into for profit under Section 23(e)(2) of the 1939 Code. However, it is well settled that a taxpayer may not pick the year in which his loss shall fall. A taxpayer's allegation that a loss occurred in a particular year must be proved, mainly by objective facts and circumstances. *Royal Packing Co.* v. *Lucas*, 38 F. 2d 180, 182 (C.A. 9th); *Boesel* v. *Commissioner*, 208 F. 2d 817, 819 (C.A. 2d). In accordance with the stated principle, a loss to be deductible must be an

unintentional parting with something of value. *Feine* v. *McGowan*, 188 F. 2d 738, 740 (C.A. 2d); *Dresser* v. *United States*, 55 F. 2d 499, 510 (C. Cls.), certiorari denied, 287 U.S. 635. A taxpayer may not voluntarily part with something of value and thereby create a loss in the particular year he chooses. This does not mean that the taxpayer may not dispose of his property by sale in the year he chooses to do so, but it does mean that when his alleged loss is based upon a sale it is essential to a transaction entered into for profit that the highest and best price be obtained for the property sold. *Feine* v. *McGowan*, *supra*. Where a taxpayer voluntarily parts with value, a transaction that may have been initiated as one for profit may, in law, be transformed into one not for profit. *Feine* v. *McGowan*, *supra*.

In this case the taxpayer testified, in effect, that the mill was worth much more than the $12,500 that he had agreed to sell it for, but that he settled for $12,500 because that was "satisfactory to" him. (R. 70, 73.) The taxpayer received *no cash* on the alleged sale, but received a note secured by a mortgage on the sawmill. (R. 113.) It is clear, therefore, that the taxpayer parted voluntarily with value and, under the principles discussed in the previous paragraph, he did not, for this reason alone, prove himself entitled to a loss deduction within the meaning of Section 23(e)(2) of the 1939 Code.

3. The taxpayer likewise has failed to prove that he owned the property upon which he bases his alleged loss. It was stipulated (R. 35), and found by the Tax Court (R. 111), that a large portion of the

investment in Eagle Timber was made with community funds of the taxpayer and his former wife, Phoebe. The taxpayer was divorced from Phoebe in 1951. (R. 116.) Accordingly, as a matter of law, one-half of the taxpayer's claimed interest in Eagle Timber, and in the property received by virtue of the liquidation of that corporation, belonged to Phoebe. *In re Coffey's Estate*, 195 Wash. 379, 81 P. 2d 283.

However, as a result of the decree of divorce which incorporated in it a settlement agreement (R. 116; Exs. H and I), the taxpayer transferred his one-half interest in the marital community to Phoebe; hence, it would appear that under local law the taxpayer owned either one-half or none of the property in question.[10] Accordingly, the taxpayer may not, for those reasons alone, take the *entire* loss allegedly sustained as an offset against his own income on a return made by him in 1952 with another wife. *Sanders* v. *Commissioner*, 225 F. 2d 629, 636 (C.A. 10th), certiorari denied, 350 U.S. 967; *Stewart* v. *Commissioner*, 95 F. 2d 821, 822 (C.A. 5th). Cf. *Poe* v. *Seaborn*, 282 U.S. 101.

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[10] Although the taxpayer testified that Phoebe never made claim to the property and that it was treated as his (R. 75), the documentary evidence shows that while she was mentally competent she took an active part in matters affecting Eagle Timber (Exs. B, G, J, K, and 4). The taxpayer did not testify that subsequent to the decree of divorce Phoebe transferred to him her interest in the properties, and, in view of the documents in evidence, such proof, if it were in the record, would have to be nothing less than unequivocal. (R. 75.)

II

The Tax Court's Finding, That the Taxpayer's Loss Allegedly Sustained In 1951, As An Escrow Agent, Was Not Incurred In His Trade or Business, Is Not Clearly Erroneous

A. ***Payments by the taxpayer to protect himself from threats of racketeers, which were threats against him personally and not against his business, are predominantly personal in nature and therefore not deductible as business expenses***

The taxpayer's contention under this point (Br. 28-35) is that he is entitled to deduct a loss which he allegedly sustained as an escrow agent as a loss "incurred in trade or business" under Section 23(e) (1) of the 1939 Code. That section, however, must be read in conjunction with the statutory mandate found in Section 24(a)(1) (Appendix, *infra*), which requires that in computing net income no deduction shall—

> *in any case* be allowed in respect of—
>
> (1) Personal, living, or family expenses * * * [Italics supplied.]

Section 24(a)(1) is broad and by its terms disallows "in any case" expenses which are in their nature personal. Thus, it prevents deductions of personal expenses which might otherwise be allowed under other provisions of the statute. Accordingly, it is held that expenses of a personal nature are not deductible regardless of business requirements. *Sparkman* v. *Commissioner*, 112 F. 2d 774 (C.A. 9th); *Commissioner* v. *Doak*, 234 F. 2d 704 (C.A. 4th). The question whether expenses are in their

nature personal is one of fact, subject to the clearly erroneous rule. *American Properties, Inc.* v. *Commissioner*, 262 F. 2d 150 (C.A. 9th).

The Tax Court found that the expenditure in question was a personal one and therefore denied the deduction. (R. 127-128.) The evidence of record on this point is as follows:

Mr. McCaskey and Mr. Fesler owned Lucky Music Company of America (hereinafter referred to as Lucky Music), which company was a client of the taxpayer. They conceived of the idea of connecting a phonograph to a slot machine so that the slot machine could be used in states where they were otherwise illegal. The principle of the idea was that the customers would not be paying to play the slot machine but would be paying to play the phonograph. (R. 85.) McCaskey and Fesler agreed, in 1949, to sell 25 machines to Fezzler, Magrini, and Lamb for a total price of $12,500 for the manufacture and delivery of the machines. At the time of the agreement the machines were not yet manufactured and the purchasers did not give Lucky Music the money but instead chose to give it to the taxpayer as escrow agent. (R. 85-86, 126.) Lucky Music did not have the money to build the machines and the $12,500 was to pay for the parts and the manufacture thereof. The obligation of the taxpayer as escrow agent was described by him as follows (R. 102):

> I was to release the money to the Lucky Music Company of America as the work progressed in the construction of these 25 machines.

Accordingly, the taxpayer paid the escrow funds to Lucky Music as the machines were built and completed, which was in 1950. (R. 126.) The purchasers, however, did not take delivery of the machines from Lucky Music in 1950 because they wished to await the outcome of an election in Tacoma, Washington. During this period McCaskey absconded with the machines and the money. (R. 86.) Fezzler, Magrini, and Lamb thereupon demanded their money from the taxpayer. The situation was described by the taxpayer as follows (R. 86): "these men, they are well known in what is called 'the rackets'. I was given the heat, that they were going to have their money or else." Solely because of the described circumstances, on April 19, 1950, the taxpayer executed a note for $12,500 in favor of the racketeers. (R. 86.) In addition, in 1950 the taxpayer assigned his interest in an existing fund on deposit in an Oregon court as a settlement with the racketeers. (R. 19, 88, 103-104.) The amount of the fund that was due the taxpayer was determined by the Oregon court on December 30, 1950. (R. 118.) The court made payment to Fezzler, Magrini, and Lamb on November 14, 1951, in the total amount of $11,083.34. (R. 103-104, 127.) The taxpayer claims one-half, or $5,541.67, of the $11,083.34 as a business loss for the year 1951.[11] (R. 16.)

[11] The reason that the taxpayer can in no event take but one-half of this loss is because the fund was community property of himself and his former wife, Phoebe, and therefore one-half of the loss is hers.

It is obviously clear that the payment in question was not necessary to, essential to, proximate to, or incurred in the taxpayer's trade or business as an attorney. But that observation is merely incidental to this portion of our discussion. The taxpayer, so far as the record shows, did not breach his escrow agreement. The terms of the escrow, as distinguished from the contract of sale, were, as the Tax Court found (R. 117), that the taxpayer was to pay the funds to Lucky Music as the machines were being constructed, and the taxpayer fully complied with the directions given him as an escrow agent (R. 102-103, 117, 126). The Tax Court, therefore, in accordance with the record before it, correctly found (R. 127) that the taxpayer did not breach his obligations as an escrow agent. Moreover, the taxpayer did not testify that he either breached or thought he breached his obligation as a depository. In 1950 the racketeers threatened him personally, put the "heat" on him, and demanded their money "or else" (R. 86); they did not threaten his business or his investment interests. Since the taxpayer did not testify as to the precise nature of the threats, it must be presumed that they were purely personal in nature, aimed at bodily harm to the taxpayer or his family—and whatever evidence there is in the case points to that conclusion. *Sparkman* v. *Commissioner*, 112 F. 2d 774, 777 (C.A. 9th); *McNeill* v. *Commissioner*, 251 F. 2d 863, 866 (C.A. 4th). The taxpayer's payment to the racketeers was made solely because of their threats and not to protect his business, to gain clients, to satisfy clients, or because

of any other factor incidental to any business the taxpayer was carrying on in the year 1951 when the loss was allegedly incurred. (R. 86, 127, 128.)

The foregoing, we submit, conclusively establishes that when the payments were made, they were made for reasons personal to the taxpayer, and he did not testify otherwise. But, even if there could be any doubt, the findings of the trial judge, on the record submitted to him, are not clearly wrong and should therefore be affirmed.[12] Indeed, since Section 24(a)

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[12] The taxpayer's contention (Br. 29) that his obligation as an escrow agent was to deliver the machines to the purchasers is without merit. It is quite true that the agreement between the seller and the purchasers was one of sale, and therefore for both the manufacture and the delivery of the machines, but the *only evidence* in the case shows that the sole direction to the taxpayer as escrow agent was to release the money to Lucky Music as the work progressed on the construction of those machines (R. 102), and that is exactly what he did in complete fulfillment of the agency (R. 102-103). It is too well settled to admit of dispute that a depositary is obligated only to the extent of the directions given to him by the depositors. The taxpayer's attempt to testify, by statements in his brief on appeal, to facts which are not in the record cannot be given credence. Likewise, the taxpayer's contention, that the facts in this record did not permit a finding that he was personally threatened and that is why he paid the racketeers, is devoid of merit. The only facts of record show, as previously discussed, that the purchasers were racketeers who wished to purchase illegal slot machines designated as record players. When they did not get the machines they put the "heat" on the taxpayer and told him to pay "or else." (R. 86.) Certainly, a conclusion that these were threats against the taxpayer's person is the only reasonable conclusion to draw, and it cannot be assailed as clearly wrong.

The taxpayer's contention (Br. 32) that these were merely threats to bring proper proceedings for a breach of an es-

(1) of the 1939 Code forbids deductions of personal expenses in any case, it is held, as previously discussed, that although a business requires an expenditure it will not be deductible if it is *essentially* personal in nature. In this case we need not go that far for, since the taxpayer did not introduce a scintilla of evidence even suggesting that his business necessitated the expenditure or that the expense was beneficial to his business, the payment was personal and nondeductible.

B. *The taxpayer's loss was not incurred in his trade or business as an attorney and therefore is not, in any eevnt, deductible under Section 23(e)(2)*

The question here is somewhat related to the question discussed under the preceding point, where it was shown that the expense or loss in question was in fact personal in nature and not deductible. The taxpayer, however, is not entitled to a deduction for the additional reason that the loss was not, in any event, incurred in a trade or business carried on by him in the taxable year 1951. The question here is whether the taxpayer's activity as an escrow agent was related to his professional activities as an attorney in the year in which he suffered the loss (*Mc-*

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crow agreement is of course not supported by the record; indeed, the taxpayer does not state that these were the true facts, but merely says that unless they were the true facts the attorney who acted for the racketeers was acting illegally. So far as that attorney is concerned, he may have acted without knowledge of the actual facts. In any event, the Tax Court must decide cases on the record before it, and the only evidence in this case supports its findings.

Neill v. *Commissioner*, 251 F. 2d 863, 866 (C.A. 4th); cf. *Holtz* v. *Commissioner*, 256 F. 2d 865, 868 (C.A. 9th)), or whether the loss was proximate to, or incurred in, or essential to, his law practice (*Putnam* v. *Commissioner*, 224 F. 2d 947, 950 (C.A. 8th), affirmed on another issue, 352 U.S. 82).

So far as the record discloses, the transaction in issue represents the first instance in which the taxpayer acted as an escrow agent. It is clear, therefore, that he was not in business as an escrow agent. Further, although it is conceivable that an attorney who suffers losses as an escrow agent may suffer losses in the practice of law where, for example, he is acting as escrow agent in his capacity as an attorney for one of the parties, that is not the present case.

The record here, as previously discussed, does not in any way indicate that the taxpayer was acting in his capacity as an attorney when he became an escrow agent or when he suffered his loss. The racketeers were not his clients and he was to receive no fee, either as an escrow agent or as an attorney. In addition, there is no showing that he thought that the transaction would help or that it did in fact help his law practice. Likewise, the payments were not made as a result of his breach of any obligation in the course of his practice as an attorney. Thus, the taxpayer has not proved that the loss was incurred by him as an attorney, or that it was essential to his practice, or that it was attributable to the operation of any trade or business engaged in by him. *Putnam* v. *Commissioner*, *supra; McNeill* v. *Com-*

missioner, *supra; Byrnes* v. *Commissioner*, decided October 16, 1940 (1940 P-H T.C. Memorandum Decisions, par. 40,516), affirmed *per curiam*, 128 F. 2d 616 (C.A. 3d); *Libby* v. *Commissioner*, decided June 30, 1955 (1955 P-H T.C. Memorandum Decisions, par. 55,180); *Miller* v. *Commissioner*, decided December 30, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,344); *Treman* v. *Commissioner*, decided July 27, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,256).

The only fact disclosed by the record that the taxpayer could possibly rely upon is that one of the parties to the transaction, namely, Lucky Music, was a client of his, but it was not Lucky Music which asked the taxpayer to act as escrow agent (R. 85), and it is uniformly held in cases where attorneys sustain losses because of transactions on behalf of their clients, even where the attorney testifies that the transaction was to benefit his law practice, that such showing, with nothing more, does not establish a loss incurred by the attorney in the operation of his trade or business. *Putnam* v. *Commissioner*, *supra; McNeil* v. *Commissioner*, *supra; Libby* v. *Commissioner*, *supra; Miller* v. *Commissioner*, *supra.* Cf. *Pokress* v. *Commissioner*, 234 F. 2d 146, 150 (C.A. 5th).

Accordingly, even if the loss in question were not personal in nature, the taxpayer failed to produce any evidence to satisfy his burden of showing that it was incurred in his trade or business, and he is not, therefore, entitled to a deduction under Section 23 (e)(1) of the 1939 Code.

C. *The taxpayer is not entitled to a deduction in the year 1951 for the additional reason that the loss occurred in the taxable year 1950*

The taxpayer argues that, since he made his return on a cash basis and in the year 1950 he gave the racketeers a note only and not cash, there was no loss in 1950. (Br. 33-34.) The taxpayer again ignores the record and his contention is without merit. The facts set out in Point II-A, *supra*, show that the taxpayer gave his note to Fezzler, Magrini, and Lamb in 1950, but also in that year he assigned to them whatever interest he had in a fund held by a court in the State of Oregon. The only facts in the case on this point show unequivocally that this assignment was in settlement of the racketeers' demands and was not security for the note. (R. 19-20, 88, 104.) The taxpayer was fully entitled to the sums which were the subject of the assignment although the rights of various individuals to whom he assigned portions of the fund were not determined until 1951. (R. 118.) Since the taxpayer in 1950 assigned all his property interest in the existing fund in satisfaction of the demand of the racketeers, he actually suffered a loss in that year, and he may not, therefore, take a deduction for the payment in 1951. Cf. *Helvering* v. *Price*, 309 U.S. 409, 413; *Joe Balestrieri & Co.* v. *Commissioner*, 177 F. 2d 867, 871 (C.A. 9th); *Heublien* v. *Commissioner*, 233 F. 2d 426 (C.A. 2d). Indeed, there were assignments of portions of the fund to others (Ex. S), and the taxpayer did not claim that he suffered his loss in the year 1951 when those assignees received payment

from the court rather than in the year when the assignments of the taxpayer's fixed property interest in the fund were executed. (Ex. P.)

Although the Commissioner did not make this contention before the trial court, it is well settled that a respondent can support the decision of a lower court on any ground and that the appellate court will affirm the trial court if its decision is correct for any reason.[13]

III

The Taxpayer's Failure to File a Declaration of Estimated Tax for the Taxable Year 1952 Was Not Due to Reasonable Cause and Therefore the Tax Court Was Clearly Correct In Finding Him Liable for An Addition To Tax Under Section 294(d)(1)(A) of the 1939 Code

Section 58(a) of the Internal Revenue Code of 1939 (Appendix, *infra*) provides that—

> Every individual * * * shall, at the time prescribed in subsection (d), make a declaration of his estimated tax for the taxable year if—
>
> * * * *
>
> (2) his gross income from sources other than wages * * * can reasonably be expected to exceed $100 for the taxable year and his gross income to be $600 or more.

Subsection (d) of Section 58 (Appendix, *infra*) provides that the declaration required under subsection

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[13] The only contention of the Commissioner in the Tax Court relating to the year in which the loss was incurred was that the taxpayer had failed to prove that the loss was incurred in 1951. (Resp. Br. 25 filed in Tax Court.)

(a) must be filed on or before March 15 of the taxable year, except that if the taxpayer's expectation of earning gross income from sources other than wages exceeding $100 and total gross income of $600 or more does not occur until later in the taxable year he may file the declaration subsequent to March 15.

The taxpayer's return for the taxable year 1952 (Ex. 1-A) discloses a gross income from sources other than wages of $44,464.65. Accordingly, it is clear that he was required to file a declaration for the year 1952. Moreover, the taxpayer did not contend in the trial court, nor does he contend before this Court, that he did not expect to earn gross income of more than $100 from sources other than wages and total gross income of $600 or more for the year 1952. Hence, the Tax Court's finding (R. 128-129) that gross income of more than $100 from sources other than wages and total gross income of at least $600 was reasonably expected in 1952 cannot be questioned. Furthermore, in view of the fact that the taxpayer's gross income for that year exceeded $40,000, it is beyond a shadow of any doubt that the taxpayer must have known during that year that he would earn gross income in an amount which would require a declaration to be filed. Nevertheless, he never filed the required declaration.

Section 294(d)(1)(A) of the 1939 Code (Appendix, *infra*) provides that in the case of a failure to make and file a declaration of estimated tax *within the time* prescribed, an addition to tax is mandatory "unless such failure is shown to the satisfaction of

the Commissioner to be due to reasonable cause and not to willful neglect".

The burden of establishing that the failure to file a return or a declaration was due to reasonable cause and not due to willful neglect is upon the taxpayer. *Lee* v. *Commissioner*, 227 F. 2d 181, 184 (C.A. 5th), certiorari denied, 351 U.S. 982; *Sanders* v. *Commissioner*, 225 F. 2d 629, 636 (C.A. 10th), certiorari denied, 350 U.S. 967; *Sabatini* v. *Commissioner*, 98 F. 2d 753, 756 (C.A. 2d). The question is one of fact, peculiarly within the province of the Tax Court and subject to the "clearly erroneous" rule. *Schmidt* v. *Commissioner* (C.A. 9th), decided November 7, 1958 (58-2 U.S.T.C., par. 9948); *Coates* v. *Commissioner*, 234 F. 2d 459, 462-463 (C.A. 8th); *Belser* v. *Commissioner*, 174 F. 2d 386, 391 (C.A. 4th), certiorari denied, 338 U.S. 893. The taxpayer does not carry this burden by merely showing an innocent mistake (*P. Dougherty Co.* v. *Commissioner*, 159 F. 2d 269, 273 (C.A. 4th), certiorari denied, 331 U.S. 838), or by showing that there was no willful neglect (*Schmidt* v. *Commissioner*, *supra; Lee* v. *Commissioner*, *supra; Calvert Iron Works, Inc.* v. *Commissioner*, 26 T.C. 770, 782), or by showing merely that he relied upon an accountant or an attorney for his tax matters (*Schmidt* v. *Commissioner*, *supra; Clark* v. *Commissioner*, 253 F. 2d 745, 751 (C.A. 3d); *Mayflower Investment Co.* v. *Commissioner*, 239 F. 2d 624, 627 (C.A. 5th); *Coates* v. *Commissioner*, *supra; Fides, A. G.* v. *Commissioner*, 137 F. 2d 731, 735 (C.A. 4th)), or by showing that he sincerely believed no return was due (*Henningsen* v. *Commis-

sioner, 243 F. 2d 954, 958-959 (C.A. 4th); *P. Dougherty Co.* v. *Commissioner, supra; Sabatini* v. *Commissioner, supra*), or by his contention that the tax year in question was a complicated year and it was not known exactly what was owing (*Peebles* v. *Commissioner*, decided June 26, 1956 (1956 P-H T.C. Memorandum Decisions, par. 56,160), affirmed *per curiam*, 249 F. 2d 92 (C.A. 4th); cf. *C.V.L. Corp.* v. *Commissioner*, 17 T.C. 812, 816). The taxpayer must affirmatively show that the failure to file on time was due to reasonable cause and not to willful neglect. A showing of innocent mistake, or of one or more of the reasons just listed, merely indicates an absence of willful neglect but does not affirmatively establish reasonable cause.

It should be noted that the majority of the cases cited *supra* deal with the addition to tax imposed by Section 291 of the 1939 Code (26 U.S.C. 1952 ed., Sec. 291), which provides for an addition to tax in the case of a failure to file tax *returns*, except where "it is shown that such failure is due to reasonable cause and not due to willful neglect". However, the provision with which we are concerned in the present case (Sec. 294(d)(1)(A)) is much stricter and provides that reasonable cause must be shown "to the satisfaction of the Commissioner". It would appear, therefore, that where, as here, reasonable cause has not been shown to the satisfaction of the Commissioner, and the trial court finds as a fact that reasonable cause does not exist, the taxpayer must show not only that the decision below is clearly wrong but must also show that the Commissioner's action

was arbitrary and capricious. In any event, as we shall show, the record fully supports the trial court's findings. Concrete support for the Tax Court's findings is the fact that the taxpayer did not testify to any extent with respect to his contention that there was reasonable cause for the failure to file a declaration. (R. 36-105.) Without such testimony, the taxpayer could hardly have been held to have carried his burden.

However, there was some testimony dealing with other issues which disclosed that the taxpayer was involved in litigation which was concluded in the year 1950. (R. 95.) In addition to that the taxpayer's return for the year 1952 was signed by an accountant. (Ex. 1-A.) The taxpayer rests his case on these two items of evidence.

The taxpayer apparently argues (Br. 63) that the litigation which was terminated in the year 1950 (R. 118) gave rise to tax problems which caused him to believe he would earn no gross income for the year 1952, and therefore he filed no declaration. This contention is without merit. The taxpayer did not testify that the litigation caused his failure to file a declaration in 1952 and, therefore, his argument here has no record support. The litigation referred to is the Umpqua court proceeding (R. 95), as a result of which the taxpayer was awarded money. It seems obvious that that litigation, which was concluded in 1950, could have no bearing upon the question whether or not the taxpayer should have filed a declaration for the taxable year 1952. There is no

showing in this record as to how the litigation which was settled with respect to the taxpayer in 1950 could affect his tax picture for 1952. Moreover, the record does not even indicate whether that court proceeding resulted in a loss or in a gain to the taxpayer. Obviously, therefore, the taxpayer has not established any relation between the Umpqua litigation and his failure to file a declaration in 1952. Indeed, he does not claim that the Umpqua litigation caused him not to file a declaration in 1952; he merely points (Br. 63) to the facts just discussed and does not himself conclude from them that they constituted reasonable cause or caused his failure to comply with the law in 1952.

Section 58(a) of the 1939 Code is unambiguous and requires the filing of a deduction if there is an expectation of gross income other than from wages of more than $100 and total gross income of at least $600. This provision is crystal clear and it is general knowledge that the instructions given with the Form 1040 tax return contain those directions. Hence, even if it were shown that the Umpqua litigation of 1950 somehow caused the taxpayer's failure to file a declaration in 1952, it would still be hardly understandable how he, an attorney, could possibly have concluded that he would not earn the gross income which would require him to file a declaration. Indeed, on his 1951 return (Ex. P) the taxpayer requested that an alleged overpayment of of tax be credited on the 1952 estimation, and that would indicate that he, as well as his accountant, expected that his gross income would be such that

he would be required to file a declaration for that year.

It seems clear that the taxpayer was either negligent or mistaken, but, as previously discussed, innocent mistake does not establish reasonable cause. Furthermore, the fact that a taxpayer has difficulties over his tax liability for previous years is hardly justification for a failure to comply with the law for a different year. *Glowinski* v. *Commissioner*, 25 T.C. 934, 936, affirmed *per curiam*, 243 F. 2d 635 (C.A. D.C.).

The taxpayer also apparently argues (Br. 63-64) that his failure to file a declaration was due to the error of his tax advisors. However, the stated defense is insufficient without proof as to the reasonableness of the reliance upon tax advisors (*Clark* v. *Commissioner*, 253 F. 2d 745, 751 (C.A. 3d); *United States* v. *Archer*, 174 F. 2d 353, 357 (C.A. 1st); *Fides, A.G.*, v. *Commissioner*, 137 F. 2d 731, 735 (C.A. 4th))—there was no such proof in this case. Moreover, in order for the taxpayer's contention to constitute a defense it must at the very least be shown (1) that he relied upon the advisor's advice regarding the filing of the declaration, and (2) that the person relied upon had full knowledge of the facts so as to enable him to know whether or not the taxpayer was required to file a declaration. *Schmidt* v. *Commissioner* (C.A. 9th), decided November 7, 1958 (58-2 U.S.T.C., par. 9948); *Mayflower Investment Co.* v. *Commissioner*, 239 F. 2d 624, 627 (C.A. 5th); *Commissioner* v. *American Ass'n of Eng. Emp.*, 204 F. 2d 19, 21 (C.A. 7th); *Girard Inv. Co.* v. *Commis-*

sioner, 122 F. 2d 843, 848 (C.A. 3d), certiorari denied, 314 U.S. 699. The only evidence in this case on the question is the fact that an accountant who was a member of an accounting firm signed the taxpayer's tax return as the person who prepared it. (See Ex. 1-A.) This establishes nothing. It certainly does not establish that the taxpayer relied upon the accountant's advice not to file a declaration; indeed, it does not even show that such advice was given. We do not know whether it was the taxpayer who made the initial decision not to file the declaration in 1952, or whether it was the taxpayer's custom to rely upon his accountant to file his returns or declarations. In the absence of such evidence we must presume that it was the taxpayer who made the initial decision not to file a declaration in 1952 and that he did not rely upon his accountant to file his returns or his declarations. See *Schmidt* v. *Commissioner*, *supra.* Moreover, as previously noted, it is difficult to believe that the taxpayer, as an attorney who is at least generally familiar with the taxing statutes, or his accountant could possibly have concluded that the taxpayer would not have sufficient gross income so that he would not be required to file a declaration in 1952. Cf. *United States* v. *Archer*, *supra*, p. 357. The record also indicates that the accountant did not have sufficient information concerning facts affecting the taxpayer's tax picture. (R. 105.) In short, there is no evidence in the record upon which the taxpayer may rely to show that he carried his burden of proof in this case.

It should also be noted that so far as the record indicates the taxpayer never did file a declaration for 1952, late or otherwise, although he certainly knew during that year that he had sufficient gross income which would require him to do so. (R. 10, 128-129.) In view of that fact and the other factors discussed, it is inconceivable that the failure to file a declaration on time was due to reasonable cause.

As previously discussed, it is not necessary that there be facts which show willful neglect. The taxpayer has not shown that the Commissioner's belief that there was no reasonable cause was arbitrary or capricious, and he has not shown that the Tax Court's finding on this matter was clearly wrong.[14] *Schmidt* v. *Commissioner, supra.*

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[14] The Tax Court also found (R. 129-130, 131) that the taxpayer was liable for additions to tax under Section 294 (d)(2) of the 1939 Code for the taxable years 1951 and 1952. The Tax Court's finding in that respect is not contested by the taxpayer on this appeal.

CONCLUSION

The Tax Court's decision is correct and should be affirmed.

Respectfully submitted,

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APRIL, 1959.

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions.

*   *   *   *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return.

*   *   *   *

(g) *Capital Losses.*—

(1) *Limitation.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

*   *   *   *

(i) *Basis for Determining Loss.*—The basis for determining the amount of deduction for losses sustained, to be allowed under subsection (e) or (f), and for bad debts, to be allowed

under subsection (k), shall be the adjusted basis provided in section 113(b) for determining the loss from the sale or other disposition of property.

* * * *

(k) *Bad Debts.*—

(1) [As amended by Sec. 124(a), Revenue Act of 1942, c. 619, 56 Stat. 798, and 113,(a), Revenue Act of 1943, c. 63, 58 Stat. 21] *General rule.*—Debts which become worthless within the taxable year; or in the discretion of the Commissioner) a reasonable addition to a reserve for bad debts; and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction. This paragraph shall not apply in the case of a taxpayer, other than a bank, as defined in section 104, with respect to a debt evidenced by a security as defined in paragraph (3) of this subsection. This paragraph shall not apply in the case of a taxpayer, other than a corporation, with respect to a non-business debt, as defined in paragraph (4) of this subsection.

* * * *

(4) [As added by Sec. 124(a), Revenue Act of 1942, *supra*,] *Non-business debts.*—In the case of a taxpayer, other than a corporation, if a non-business debt becomes worthless within the taxable year, the loss resulting therefrom shall be considered a loss from the sale or exchange, during the

taxable year, of a capital asset held for not more than 6 months. The term "non-business debt" means a debt other than a debt evidenced by a security as defined in paragraph (3) and other than a debt the loss from the worthlessness of which is incurred in the taxpayer's trade or business.

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) [As amended by Sec. 127(b), Revenue Act of 1942, *supra*] *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23(x);

* * * *

(26 U.S.C. 1952 ed., Sec. 24.)

SEC. 58 [As amended by Sec. 13(a), Individual Income Tax Act of 1944, c. 210, 58 Stat. 231]. DECLARATION OF ESTIMATED TAX BY INDIVIDUALS.

(a) [As amended by Sec. 202(a), Revenue Act of 1948, c. 168, 62 Stat. 110] *Requirement of Declaration.*—Every individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as defined in section 1621(a), withholding under Subchapter D of Chapter 9 is not made applicable) shall, at the time prescribed in subsection (d), make a declaration of his estimated tax for the taxable year if—

(1) his gross income from wages (as defined in section 1621) can reasonably be expected to exceed the sum of $4,500 plus $600 with respect to each exemption provided in section 25(b); or

(2) his gross income from sources other than wages (as defined in section 1621) can reasonably be expected to exceed $100 for the taxable year and his gross income to be $600 or more.

* * * *

(d) [As amended by Sec. 13(d), Individual Income Tax Act of 1944, *supra*] *Time and Place for Filing.*—

(1) *In general.* — The declaration required under subsection (a) shall be filed on or before March 15 of the taxable year, except that if the requirements of section 58(a) are first met

(A) after March 1 and before June 2 of the taxable year, the declaration shall be filed on or before June 15 of the taxable year, or

(B) after June 1 and before September 2 of the taxable year, the declaration shall be filed on or before September 15 of the taxable year, or

(C) after September 1 of the taxable year, the declaration shall be filed on or before January 15 of the succeeding taxable year.

* * * *

(26 U.S.C. 1952 ed., Sec. 58.)

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * *

(26 U.S.C. 1952 ed., Sec. 111.)

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

* * * *

(c) [As amended by Sec. 147, Revenue Act of 1942, *supra*] *Distributions in Liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsec-

tion (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. * * *.

(26 U.S.C. 1952 ed., Sec. 115.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 210(a), Revenue Act of 1950, c. 944, 64 Stat. 906] *Capital assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

(A) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

* * * *

(d) [As amended by Sec. 150(c), Revenue Act of 1942, *supra*] *Limitation on Capital Losses.*—

(1) *Corporations.*—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of gains from such sales or exchanges.

(2) *Other taxpayers.*—In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets

shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer of $1,000, whichever is smaller. For purposes of this paragraph, net income shall be computed without regard to gains or losses from sales or exchanges of capital assets.

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(26 U.S.C. 1952 ed., Sec. 117.)

Sec. 294. Additions to The Tax in Case of Nonpayment.

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(d) [As added by Sec. 118(a), Revenue Act of 1943, *supra*] *Estimated Tax.*—

(1) *Failure to file declaration or pay installment of estimated tax.*—

(A) *Failure to File Declaration.*—In the case of a failure to make and file a declaration of estimated tax within the time prescribed, unless such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause and not to willful neglect, there shall be added to the tax 5 per centum of each installment due but unpaid, and in addition, with respect to each such installment due but unpaid, 1 per centum of the unpaid amount thereof for each month (except the first) or fraction thereof during which such amount remains unpaid. * * *.

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(26 U.S.C. 1952 ed., Sec. 294.)

2 Revised Code of Washington:[15]

Sec. 23.01.050 *Filing articles—Certificate of incorporation—Issuance.* (1) Triplicate originals of the articles of incorporation shall be delivered to the secretary of state. If the secretary of state finds that the articles of incorporation conform to law he shall put an endorsement of his approval upon each set, and when all taxes, fees and charges have been paid as required by law, he shall file one of such sets of articles in his office, and shall record the same, and shall issue a certificate of incorporation.

(2) Upon the issue of the certificate of incorporation, the corporate existence shall begin, and subject to the provisions of RCW 23.01.060, those persons who subscribed for shares prior to the issuance of the certificate of incorporation, or their assigns, shall be shareholders in the corporation.

(3) The certificate of incorporation together with the two remaining sets of the articles of incorporation bearing the endorsement of the

[15] Eagle Timber, the corporate entity in question in this case, was incorporated under the provisions of the Revised Statutes of Washington and during the years that it was in existence those were the governing statutes. Sections 3803-5, 3803-7, 3803-8, 3803-9, 3836-13 and 3836-15 of 5 Remington's Revised Statutes of Washington Annotated, 1940 Annual Pocket Part, are substantially identical with Sections 23.01.050, 23.01.070, 23.01.080, 23.01.090, 23.60.140, and 23.60.150, respectively, of 2 Revised Code of Washington set out in this Appendix. Since the taxpayer relies (Br. 17-23) upon the provisions of the Revised Code in his brief, and since the applicable provisions of 5 Remington's Revised Statutes are substantially identical therewith, for the sake of simplicity we, likewise, refer to the provisions of the Revised Code in this brief.

fact and time of filing in the office of the secretary of state shall be returned to the incorporators or their representative. One of the sets of the articles of incorporation shall then be filed in the office of the auditor of the county in which the registered office of the corporation is stiuated, and the other shall be retained by the corporation.

Sec. 23.01.070. *Paid-in capital — Minimum.* The amount of paid-in capital with which a corporation may begin business shall not be less than five hundred dollars in cash or other property taken at a fair valuation.

Sec. 23.01.080 *Commencement of business —Prerequisites — Penalty.* (1) A corporation formed under this chapter shall not incur any debts or begin the transaction of any business, except such as is incidental to its organization or to the obtaining of subscriptions to or the payment for its shares, until:

(a) A triplicate original of the articles of incorporation has been filed in the office of the auditor as provided in RCW 23.01.050;

(b) the amount of paid-in capital with which it will begin business, as stated in the articles of incorporation, has been fully paid; and

(c) there has been filed in the office of the auditor of the county in which the corporation has its registered office an affidavit signed by at least a majority of the board of directors stating that the amount of paid-in capital with which it will commence business, as stated in the articles of incorporation, has been fully paid.

(2) If a corporation has transacted any business in violation of this section, the officers who participated therein and the directors, except

those who dissented therefrom and caused their dissent to be filed at the time in the registered office of the corporation, or who, being absent, so filed their dissent upon learning of the action, shall be severally liable for the debts or liabilities of the corporation arising therefrom.

Sec. 23.01.090. *Certificate evidence of incorporation.* The certificate of incorporation issued by the secretary of state in accordance with the provisions of RCW 23.01.050 shall be conclusive evidence of the fact that the corporation has been incorporated. Proceedings may, however, be instituted by the state to dissolve, wind up and terminate a corporation which should not have been formed under this chapter, or which has been formed without a substantial compliance with the conditions prescribed by this chapter as precedent to incorporation.

Sec. 23.60.140. *Dissolution for nonpayment of fees—Corporate name.* In the event that any corporation, which has failed to pay fees provided for by existing laws for a period of three consecutive years, shall fail to pay said fees in full on or before July 1, 1937, it shall be the duty of the secretary of state to enter upon his records a notation that such corporation is dissolved and said corporation shall thereupon be dissolved and the secretary of state shall thereupon be free to grant the name of the corporation so dissolved to any other corporation thereafter organized.

Sec. 23.60.150 *Dissolution for nonpayment—Trusteeship of assets.* In the event of dissolution of any corporation for the nonpayment of fees either by court action or otherwise the trustees of such corporation shall hold the title to

> such property of the corporation for the benefit of its creditors and stockholders to be disposed of under appropriate court proceedings. Any unpaid balance of fees due the state of Washington shall remain and be a prior and preferred claim against said assets and be paid to the secretary of state before any payment to creditors and stockholders.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> SEC. 29.23(e)-1. *Losses by Individuals.*—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if (a) incurred in the taxpayer's trade or business, or (b) incurred in any transaction entered into for profit, or (c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or (d) if not prohibited or limited by any of the following sections of the Internal Revenue Code: Sections 23(g) and 117, relating to capital losses; section 23(h), relating to wagering losses; section 24(b), relating to losses from sales or exchanges of property between persons designated therein; section 112, relating to recognition of gain or loss upon sales or exchanges of property; section 118, relating to losses on wash sales of stock or securities; section 251, relating to income from sources within possessions of the United States; and section 252, relating to citizens of possessions of the United States. * * *.

* * * *

Section 39.23(e)-1(a) of Treasury Regulations 118, promulgated under the Internal Revenue Code of 1939, applicable to years beginning after December 31, 1951, contains language identical with the above-quoted provisions of Treasury Regulations 111, applicable to the taxable year 1951 here involved.

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